17 November 2017

ASIC Enforcement Review
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: ASICenforcementreview@Treasury.gov.au

Dear Madam/Sir,

SMSF ASSOCIATION SUBMISSION ON STRENGTHENING PENALTIES FOR CORPORATE AND FINANCIAL SECTOR MISCONDUCT

The Self Managed Super Fund Association (SMSFA) understands the concerns regarding penalties in legislation administered by the Australian Securities and Investment Commission (ASIC) may not be effective in reflecting community perceptions to the seriousness of engaging in certain forms of misconduct.

Therefore, we are supportive of the timely system review in order to ensure that the penalty system is sufficiently dissuading misconduct within the financial services industry. We believe consistency between jurisdictions, appropriate pecuniary and imprisonment penalties and reflecting the views of the community should be the overriding principles in the review.

As identified by the Financial Services Inquiry and through a number of forums we agree that certain penalties for corporate and financial sector misconduct are too low to act as a 'credible deterrent'. While the SMSFA supports the strengthening of penalties we also warn that additional penalties and stronger legislation may not ultimately result in increased protections from corporate and financial sector misconduct, as offenders who are willing to engage in bad behaviour are ordinarily still likely to continue engaging in bad behaviour.

Broadly the SMSFA supports the notion that maximum civil penalties must not be substantially lower than the potential profits from misconduct and support the consideration of disgorgement of profits in civil proceedings. Any penalty system should try to remove the aspect that a pecuniary penalty is just part of 'the cost of doing business' for directors.

The Association is also generally supportive of administrative and efficiency improvements such as the proposed formula that connects maximum criminal imprisonment with maximum pecuniary penalties and rectifying the inconsistences with penalties for equivalent Commonwealth and State provisions. We also support the removal of imprisonment for strict liability provisions due to the lack of mental fault that must be proved.

At the same time we note that provisions must not go too far to penalise advisors unfairly when other parties should and can be held accountable for their actions. The legislation should provide a

healthy balance that allows ASIC to determine when criminal prosecution is necessary but also ensure that ASIC do not over regulate through the use of civil penalties and infringement notices.

We make comment on the specific positions the Taskforce seek consultation as follows:

Position 1: The maximum imprisonment penalties for criminal offences in ASIC-administered legislation should be increased as outlined in Annexure B.

The SMSFA supports this position. We have no concerns with the proposed maximum imprisonments in Annexure B.

Position 2: The maximum pecuniary penalties for all criminal offences (other than the most serious class of offences – See Annexure B) in ASIC-administered legislation should be calculated by reference to the following formula:

Maximum term of imprisonment in months multiplied by 10 = penalty units for individuals, multiplied by a further 10 for corporations.

The SMSFA believes that maximum pecuniary penalties for criminal offences should be increased to keep in line with current community standards and to provide a strong 'credible deterrent' to potential misbehavers. This is particularly relevant when discussing unlicensed conduct, disclosure breaches and elements of dishonest behaviour which attract maximum penalties well below other forms of corporate and financial sector misconduct. We support the proposals to place these penalties in line with the other forms of corporate and financial sector misconduct.

The SMSFA is generally supportive of a regime where maximum pecuniary amounts are determined by reference to a formula based on the maximum term of imprisonment. We understand this ensures a system of certainty and causational link between offences which increases transparency in the system.

However, we do have concerns that a statutory formula may be too rigid for the determination of a pecuniary maximum penalty. Consultation with industry should confirm that no maximum penalties are set too high or too low in comparison with the maximum imprisonment penalty. In this sense any formula must have certain requirements built in that allow for courts to determine that the general formula need not apply. We agree with the position that the most serious class of offences should not have any reference to a formula.

Other than when the maximum imprisonment and pecuniary penalty is given we also believe there should be no predetermined link between actual sentences handed down by the court. For example, if an individual is given two years imprisonment for an offence, it does not require them to be also sentenced to 240 penalty units. The system should be designed so that there is flexibility in allowing the courts decide the appropriate individual penalty under the maximum framework.

Position 3: The maximum penalty for a breach of section 184 should be increased to reflect the seriousness of the offence.

The SMSFA supports the increase of the maximum penalty of section 184 of the *Corporations Act 2001* (Corporations Act) in order to be aligned with State-based fraud offences. We believe ten years

satisfies this purpose. The increased penalty will further encourage efficiency and ASIC's ability to prosecute corporate offences.

Position 4: The Peters test should apply to all dishonesty offences under the Corporations Act

The SMSFA is supportive of proposals that provide consistency in the corporate and financial sector and therefore do not have any large objection to the *Peters* test. We believe the objective standard in the Peters test is appropriate for dishonesty offences in the Corporations Act given the public's high expectations for behaviour in the corporate and financial services sectors. We would also encourage the Commonwealth to consider amending the Criminal Code to adopt the Peters test for consistency.

Position 5: Remove imprisonment as a possible sanction for strict and absolute liability offences.

The SMSFA agrees with this position. Our view is that strict and absolute liability offences which do not need proof of mental fault should not be punished by imprisonment. As stated in the paper, inadvertent breaches of the law may unfairly impose a significant sanction on an individual. This is of greater importance when dealing typically with 'white collar' crimes.

Position 6: Introduce an ordinary offence to complement a number of strict and absolute liability offences as outlined in Annexure C.

The SMSFA is supportive of introducing ordinary offences to complement strict and absolute liability offences where it is appropriate. The offence penalty structure of offences in Annexure C should be designed as per section 952C of the Corporations Act, which also applies an ordinary offence. ASIC should determine when it is necessary to prosecute under the ordinary offence provisions based upon the facts of the case before it.

Position 7: Maximum pecuniary penalties for strict and absolute liability offences should be a minimum of 20 penalty units for individuals and 200 penalty units for corporations.

The SMSFA is supportive of proposals that reduce the risk that offenders do not breach laws where pecuniary penalties can be seen as part of the 'cost of doing business'. If imprisonment is removed as a sanction for strict and absolute liability offences then the maximum pecuniary penalty should increase to provide a further deterrent.

The SMSFA sees no preliminary issue with the proposed penalty.

Position 8: All strict and absolute liability offences should be subject to the penalty notice regime.

The SMSFA is supportive of this proposal if imprisonment is removed as a possible sanction for strict and absolute liability offences. This would allow ASIC a further tool to effectively enforce these offences with administrative ease and an important disincentive in the absence of potential imprisonment.

We believe it is essential that this proposal does not stop ASIC from pursuing contravention of the underlying offence and higher penalties in appropriate circumstances otherwise we would not support a penalty notice regime. Penalty notices should only be used for lower level breaches.

The SMSFA does not have a final position on the amount that a penalty should be set as but it should not be over half the maximum pecuniary penalty and not be so little as to undermine the seriousness of lower level breaches.

Position 9: Maximum civil penalty amounts in AISC-administered legislation should be increased.

The SMSFA supports the position that maximum civil penalty amounts in ASIC-administered legislation should be increased in some form. As for the reasons stated throughout our submission, corporate and financial sector misconduct penalties need to act as a 'credible deterrent' to potential misbehavers.

We believe that maximum civil penalties should be set in penalty units in the Corporations Act, ASIC Act and Credit Act. This sets a level of consistency for ASIC to administer upon across all codes which will help increase efficiency in prosecution. Penalty units will also provide a platform for certain penalty formulas to be based upon. This will allow for cohesion with criminal penalties and provide for effective reviews to be conducted in the future.

With civil penalties set in penalty units it also allows for pecuniary amounts to move in line with inflation more regularly and accurately. As the paper states, current civil penalties have not moved with inflation and at the very least the SMSF supports that maximum civil penalties are now aligned with inflation and current day community standards.

The SMSFA is also supportive of penalties that are based around benefits gained or losses avoided. Introducing this into the framework clearly eradicates any potential gain a misbehaver may make in the corporate and financial sector. The Association supports the examination of overseas jurisdictions to help shape this proposal.

Position 10: Disgorgement remedies should be available in civil penalty proceedings brought by ASIC under the Corporations, Credit and ASIC Acts.

The SMSFA is open to the inclusion of a general disgorgement remedy that may be ordered on the application of ASIC. The court will then have the right to determine if the remedy is appropriate. A disgorgement remedy is potentially the most effective deterrent, bar imprisonment, that may dissuade misconduct. If individuals know that potential misconduct will result in no end financial gain to them, they may have no reasons to engage in misconduct.

The courts must ensure that the use of the disgorgement remedy is appropriate and not excessively used in scenarios where the standard pecuniary penalty under the law is sufficient. The SMSFA believes that there must be express and sole intent in the wrongdoer's action to dishonestly profit from their behaviour.

Position 11: The Corporations Act should require courts to give priority to compensation.

The SMSFA supports this position. The victim must be given every opportunity to be compensated as a result of misconduct in the corporate and financial sector.

Position 12: Civil penalty consequences should be extended to a range of conduct prohibited in AISC-administered legislation.

The SMSFA understands the proposal behind extending civil penalty consequences to a range of conduct that currently only has criminal penalties. Opening up these behaviours to civil penalties does give ASIC greater flexibility and ease in prosecuting bad behaviour. In turn, these extensions must not go too far to lessen the impact and use of the criminal code. Individuals who purposely engage in bad behaviour must be held accountable to the highest standards of the law first.

- Failure to provide and defective disclosure and takeover documents
    - We support this proposal.
- Financial services- disclosure
    - We support this proposal.
- Financial services and markets – unlicensed conduct
    - Whilst we do support this proposal for inadvertent breaches of requiring an Australian Financial Services Licence, the SMSFA strongly believes that criminal prosecution should always take priority for these breaches if there is any form of intent involved. ASIC should not pursue a civil route purely because it is easier to prosecute.
- Financial services – failure to comply with client money obligations
    - We support the proposal with the same concerns as above.
- Financial services and markets – failure to notify ASIC of breaches of obligations
    - We support this proposal.

Position 13: Key provisions imposing obligations on licensees should be civil penalty provisions.

The SMSFA's preliminary view is that certain key provisions which impose obligations on licensees may benefit from civil penalty provisions. We agree with the statement in the discussion paper that attaching a civil penalty to the obligation of Australian financial service licensees to comply with financial services laws may cause duplication between the general obligation and specific provisions to which a civil penalty also applies. Unfortunately, we do not have enough information in order to determine how extensive this proposal should be.

Position 14: Civil penalty consequences should be extended to insurers that contravene certain obligations under the Insurance Contracts Act 1984.

The SMSFA does not have a position on the *Insurance Contracts Act 1984*.

Position 15: Infringement notices be extended to an appropriate range of civil penalty offences

The SMSFA does not believe that infringement notices should be extended to further civil penalty offences. Infringement notices currently work effectively in the financial industry in that they reduce the cost and time for ASIC in pursuing less serious contraventions. Furthermore, they enable ASIC to signal to the market its views on breaches of laws extremely effectively.

We believe any furthering of the infringement regime will lessen the effective impact and use of civil penalty provisions. Civil provisions, as the paper notes, play an important part in regulating and punishing misconduct in financial services and the proposal to expand civil provisions throughout the

paper clearly indicates how effective they can be. For this reason, we believe that recommendations should be focused on improving both the civil and criminal systems before infringement notices are reviewed.

Position 16: Infringement notices should be set at 12 penalty units for individuals and 60 penalty units for corporations for any new infringement notice provisions.

The SMSFA does not have a position on the penalty units for infringement notices.

If you have any questions about our submission please do not hesitate in contacting us.

Yours sincerely,

John Maroney
Chief Executive Officer
SMSF Association

ABOUT THE SMSF ASSOCIATION

The SMSF Association is the peak professional body representing SMSF sector which is comprised of over 1.1 million SMSF members who have $696 billion of funds under management and a diverse range of financial professionals servicing SMSFs. The SMSF Association continues to build integrity through professional and education standards for advisors and education standards for trustees. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial planners and other professionals such as tax professionals and actuaries. Additionally, the SMSF Association represents SMSF trustee members and provides them access to independent education materials to assist them in the running of their SMSF.